

## SENATE FISCAL AGENCY MEMORANDUM

**DATE:** September 25, 2007

**TO:** Members of the Senate

**FROM:** Jay Wortley, Senior Economist

**RE:** Tax Bills Passed by the House September 24, 2007

On September 24, 2007, the House of Representatives passed seven bills that would generate additional tax revenue in FY 2006-07 and FY 2007-08. The House is combining these bills with five bills it passed on April 17, 2007, that would also generate new revenue. These 12 tax bills fall into two groups:

- 1) **Taxpayer Lawsuit Remedies:** Three of these bills would remedy retroactively two recent tax issues arising from taxpayer lawsuits and as a result, would eliminate the need for the Department of Treasury to make court-required sales and use tax refunds. Eliminating these refunds would save the State \$145.0 million to \$343.0 million in FY 2006-07 (these refunds would be booked against FY 2006-07) and would eliminate an ongoing reduction in sales and use tax collections of an estimated \$59.0 million annually beginning in FY 2007-08.
- 2) **Elimination of Various Tax Exemptions:** The remaining nine bills propose to eliminate various tax exemptions, tax collection allowances, and bad debt allowances that would primarily directly impact businesses. The provisions in these nine bills would increase tax revenue in FY 2007-08 by an estimated \$347.6 million. The fiscal impact of each of these bills is summarized in the attached table.

These bills are summarized below.

### **HOUSE-PASSED TAXPAYER LAWSUIT REMEDY BILLS**

#### **H.B. 4882 – Use Tax, Converting Property From Exempt to Nonexempt Use**

This bill would amend the Use Tax Act to clarify under what circumstances a taxpayer that converts acquired property from exempt to nonexempt use must pay use tax for its exempt use. The Michigan Court of Appeals recently ruled that under existing law auto dealers do not have to pay use tax on vehicles that are used by employees prior to selling them at retail because these vehicles are being held for resale, and items held for resale are tax-exempt. As a result of this Court decision and the current language in statute, the Department of Treasury will have to make use tax refunds ranging from \$66.0 million to \$250.0 million in FY 2006-07 and will incur an ongoing reduction in use tax collections totaling an estimated \$29.0 million annually beginning in FY 2007-08. The intent of this bill is to clarify existing law and apply this clarification retroactively. As a result, this bill would eliminate the need for making these refunds in FY 2006-07 and would eliminate any ongoing reductions in use tax collections beginning in FY 2007-08.

## **H.B. 5096 and H.B. 5097 – Bad Debt Allowance**

These bills would amend the Use and Sales Tax Acts to clarify who may claim a bad debt allowance. This bill is also in response to a recent Court of Appeals ruling that allowed a bad debt allowance that was not the intent of current law. This bill attempts to clarify the bad debt provisions and retroactively would be applied to express the original intent of the law. Without these clarifications, the Department of Treasury estimates that sales and use tax refunds totaling \$79.0 million to \$93.0 million will have been made in FY 2006-07 and ongoing reductions in these taxes totaling an estimated \$30.0 million will be incurred annually beginning in FY 2007-08. These bills would eliminate the need for making these refunds and would eliminate any ongoing reductions in the sales or use tax collections beginning in FY 2007-08.

## **HOUSE-PASSED BILLS TO ELIMINATE CERTAIN TAX EXEMPTIONS**

### **H.B. 5252 – Tobacco Tax Collection and Bad Debt Allowances (Passed House 9/24/07)**

This bill would amend the Tobacco Products Tax Act to eliminate the collection and bad debt allowance currently granted to tobacco wholesalers who collect the cigarette and other tobacco products taxes. Under current law, wholesalers are permitted to retain 1.5% of the tobacco tax they collect from their customers to compensate them for any costs incurred to collect these taxes. In addition, wholesalers are currently allowed to deduct taxes that are determined to be uncollectible from their customers. This bill would eliminate the collection allowance and the bad debt allowance beginning in FY 2007-08 and would increase tobacco tax revenue an estimated \$17.6 million in FY 2007-08.

### **H.B. 5253 – Income Tax Accelerated Depreciation (Passed House 9/24/07)**

This bill would eliminate the accelerated rate at which taxpayers can currently depreciate real and personal property under Michigan's income tax. The preliminary estimate is that this change would increase income tax collections \$75.0 million in FY 2007-08.

### **H.B. 5254 and H.B. 5255 – Sales and Use Tax Exemptions (Passed House 9/24/07)**

This bill would eliminate several current exemptions to the sales and use taxes beginning in FY 2007-08. These proposed changes would eliminate exemptions for purchases of telecommunication services, periodicals, water pollution equipment, food and drinks sold through vending machines, and aircraft parts. This bill also would eliminate the current exemption for the cost of meals provided by employers to employees at a reduced cost or for free. In addition, this bill would eliminate bad debt allowances for the sales and use taxes currently granted to retail businesses that collect these taxes, beginning in FY 2007-08. These exemptions would reduce sales and use tax collections an estimated \$188.0 million in FY 2007-08, and a breakdown of these proposed tax changes are summarized in the attached table.

### **H.B. 4384 – Elimination of Water Softener Exemption (Passed House 4/17/2007)**

This bill would eliminate the current property tax exemption for water conditioning systems used in residential dwellings. This would increase State education tax revenue \$0.3 million in FY 2007-08.

**H.B. 4385 – Increase Tax Penalties (Passed House 4/17/2009)**

This bill would increase penalties on late tax payments effective June 1, 2007, and would generate an estimated \$5.1 million in FY 2007-08.

**H.B. 4386 – Tax Affiliates With Nexus in Michigan (Passed House 4/17/2007)**

The bill would create provisions for nexus among business affiliates. The bill is intended to address instances where a business organizes itself into separate entities in order to evade taxation; such as if a traditional retail business creates a separate online business through which sales into Michigan are channeled. The bill is estimated to increase use tax revenue in FY 2007-08 by approximately \$3.6 million.

**H.B. 4387 & H.B. 4388 – Elimination of Oil & Gas Income Tax Exemption (Passed House 4/17/07)**

These bills would eliminate a current provision in the income tax that allows oil and gas production businesses to deduct their business expenses from the income tax, even though their income derived from oil and gas production is taxed under the oil and gas severance tax, not the income tax. This bill would increase income tax revenue an estimated \$3.9 million in FY 2007-08.

I hope this information is helpful to you. If you have any questions, please let me know.

/kjh

c: Gary S. Olson, Director  
Ellen Jeffries, Deputy Director

**Bills Eliminating Tax Exemptions Passed By The House**  
**Estimated Fiscal Impact for FY 2007-08**  
(millions of dollars)

<b>Tax Item</b>	<b>Tax</b>	<b>Bill(s)</b>	<b>Proposed Change</b>	<b>Effective Date</b>	<b>Fiscal Impact FY 2007-08</b>
<b><u>Bills Passed September 24, 2007</u></b>					
Telecommunications Services .....	Use	HB 5254	Eliminate Exemption	10/1/2007	\$37.0
International and Other Calls .....	Use	HB 5254	Eliminate Exemption	10/1/2007	17.0
Periodicals .....	Sales/Use	HB 5254 & 5255	Eliminate Exemption	10/1/2007	44.0
Water Pollution Equipment .....	Sales/Use	HB 5254 & 5255	Eliminate Exemption	10/1/2007	44.0
Employer Provided Meals.....	Sales/Use	HB 5254 & 5255	Eliminate Exemption	10/1/2007	8.4
Food Sold Through Vending Machines .....	Sales/Use	HB 5254 & 5255	Eliminate Exemption	10/1/2007	21.0
Aircraft Parts .....	Sales/Use	HB 5254 & 5255	Eliminate Exemption	10/1/2007	6.7
Bad Debts Allowance.....	Sales/Use	HB 5254 & 5255	Eliminate	10/1/2007	64.0
Tobacco Tax Collection & Bad Debt Allowances .....	Tobacco Tax	HB 5252	Eliminate	10/1/2007	17.6
Accelerated Depreciation.....	Income Tax	HB 5253	Eliminate	1/1/2008	75.0
<b>Subtotal: Tax Bills Passed by House 9/24/2007 .....</b>					<b>\$334.7</b>
<b><u>Bills Passed by House April 17, 2007</u></b>					
Water Softeners .....	State Education	HB 4384	Eliminate Exemption	1/1/2008	\$0.3
Increase Penalties on Late Payment of Taxes .....	Revenue Act	HB 4385	Increase Penalties	7/1/2007	5.1
Affiliates With Nexus in Michigan, Assess Use Tax .....	Use Tax	HB 4386	Tax Affiliates w/Nexus	10/1/2007	3.6
Oil & Gas Income Tax Exemption.....	Income Tax	HB 4387&8	Eliminate Exemption	1/1/2008	<u>3.9</u>
<b>Subtotal: Tax Bills Passed by House 4/17/2007 .....</b>					<b>\$12.9</b>
<b>Total Revenue Gain from House Passed Tax Bills .....</b>					<b>\$347.6</b>

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